

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Costa and Poochigian Analyst: Jeani Brent Bill Number: SB 84

Related Bills: See Legislative History Telephone: 845-3410 Introduced Date: 12/07/1998

Attorney: Doug Bramhall

Sponsor:

SUBJECT: Enterprise Zones/Expansion Areas

SUMMARY

This bill would make various modifications to the rules regarding expansion of enterprise zones.

EFFECTIVE DATE

This bill would take effect immediately as an urgency statute and apply to taxable or income years beginning on or after January 1, 1999.

LEGISLATIVE HISTORY

AB 51 (1999); AB 2798 (Stats. 1998, Ch. 323), AB 2809 (Stats. 1998, Ch. 1039); AB 3, AB 69, AB 82, AB 638, AB 809, AB 1217 (Stats. 1997, Ch. 602), SB 200 (Stats. 1997, Ch. 609), SB 635, SB 965 (Stats. 1997, Ch. 603); AB 2456 (1996), AB 296 (Stats. 1996, Ch. 953), SB 715 (Stats. 1996, Ch. 952), SB 2023 (Stats. 1996, Ch. 955); SB 712 (Stats. 1995, Ch. 494); AB 2206 (Stats. 1994, Ch. 853), SB 1438 (Stats. 1994, Ch. 754), SB 1770 (Stats. 1994, Ch. 755).

PROGRAM HISTORY/BACKGROUND

California has four types of economic development areas that have similar tax incentives:

- Enterprise Zones,
- Local Agency Military Base Recovery Areas (LAMBRA),
- Targeted Tax Area (TTA), and
- Manufacturing Enhancement Areas (MEA)

The following table shows the incentives available to each of the economic development areas.

Types of Incentives	EZ	LAMBRA	TTA	MEA
Sales or Use Tax Credit	X	X	X	
Hiring Credit	X	X	X	X
Employee Wage Credit	X			
Business Expense Deduction	X	X	X	
Net Interest Deduction	X			
Net Operating Loss	X	X	X	

Board Position:

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Department Director

Date

Gerald Goldberg

1/19/1999

SPECIFIC FINDINGS

Under the Government Code, existing state law allows the governing body of a city or county to apply for designation as an enterprise zone. Using specified criteria, the Trade and Commerce Agency (TCA) designates enterprise zones from the applications received from the governing bodies. Enterprise zones are designated for 15 years (except enterprise zones meeting certain criteria may be extended to 20 years), and TCA has designated each of the 39 enterprise zones authorized under existing law. When an enterprise zone expires, TCA is authorized to designate another in its place.

TCA may approve the geographic expansion of enterprise zones up to 15% in size and, for certain small enterprise zones, up to 20% in size. Proposed expansion areas must meet the same criteria required for designation of an enterprise zone. Designation criteria require that the designation application propose effective, innovative, and comprehensive regulatory, tax, program, and other incentives in attracting private sector investment in the enterprise zone. If the expansion is proposed to be made into an adjacent city or cities, the general enterprise zone designation criteria and the following criteria must be met:

1. The governing bodies of the adjacent city or cities into which the expansion would occur must approve the expansion.
2. The land of the proposed expansion area must be zoned for industrial or commercial use.
3. Basic infrastructure, such as gas, water, electrical, and sewer service, must be available in the proposed expansion area.

Under the Revenue and Taxation Code, existing state law provides special tax incentives for taxpayers conducting business activities within an enterprise zone. These incentives include a sales or use tax credit, hiring credit, business expense deduction, special net operating loss treatment, and net interest deduction. In addition, a wage credit may be claimed by specified employees of businesses operating within an enterprise zone.

Sales or Use Tax Credit

The enterprise zone sales or use tax credit is allowed for an amount equal to the sales or use taxes paid on the purchase of qualified property purchased for exclusive use in an enterprise zone. The amount of the credit is limited to the tax attributable to enterprise zone income. Qualified property is defined as:

- Machinery and machinery parts used to
 - (1) manufacture, process, combine, or otherwise fabricate a product;
 - (2) produce renewable energy resources; or
 - (3) control air or water pollution.
- Data processing and communication equipment.
- Motion picture manufacturing equipment.

In addition, qualified property must be purchased and placed in service before the enterprise zone designation expires. The maximum value of property that may be eligible for the enterprise zone sales or use tax credit is \$1 million for individuals and \$20 million for corporations.

Hiring Credit

A business located in an enterprise zone may reduce tax by a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated an enterprise zone and meet certain other criteria. At least 90% of the qualified employee's work must be directly related to a trade or business located in the enterprise zone and at least 50% must be performed inside the enterprise zone. The business may claim up to 50% of the wages paid to a qualified employee as a credit against tax imposed on enterprise zone income. The credit is based on the lesser of the actual hourly wage paid or 150% of the current minimum hourly wage. The amount of the credit must be reduced by any other federal or state jobs tax credits, and the taxpayer's deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring credit.

Business Expense Deduction

A business located in an enterprise zone may elect to deduct as a business expense a specified amount of the cost of qualified property purchased for exclusive use in the enterprise zone. The deduction is allowed in the taxable year in which the taxpayer places the qualified property in service. The basis of the property must be reduced by the amount of the deduction. The maximum deduction for all qualified property is the lesser of 40% of the cost or the following:

If the property was placed in service:

Months after Designation	Maximum deduction
0 to 24	\$40,000
25 to 48	30,000
48 and over	20,000

Net Operating Loss Deduction

A business located in an enterprise zone may elect to carry over 100% of the enterprise zone net operating losses (NOLs) to deduct from enterprise zone income of future years. The election must be made on the original return for the year of the loss. The NOL carryover is determined by computing the business loss that results from business activity in the enterprise zone.

Net Interest Deduction

A deduction from income is allowed for the amount of net interest earned on loans made to a trade or business located in an enterprise zone. Net interest is defined as the full amount of the interest less any direct expenses (e.g., commission paid) incurred in making the loan. The loan must be used solely for business activities within the enterprise zone, and the lender may not have equity or other ownership interest in the enterprise zone trade or business.

Employee Wage Credit

Certain disadvantaged individuals are allowed a credit for wages received from an enterprise zone business. Public employees are not eligible for the credit. The amount of the credit is 5% of "qualified wages," defined as wages subject to federal unemployment insurance. For each dollar of income received by the taxpayer in excess of qualified wages, the credit is reduced by nine cents. The credit is not refundable and cannot be carried forward. The amount of the credit is limited to the amount of tax that would be imposed on income from employment in the enterprise zone, computed as though that income represented the taxpayer's entire taxable income.

Apportioning

For businesses operating inside and outside an enterprise zone, the amount of credit or net operating loss deduction that may be claimed is limited by the amount of tax or income attributable to the enterprise zone. Income is first apportioned to California using the same formula as that used by all businesses that operate inside and outside the state (property, payroll, a double-weighted sales factor). This income is further apportioned to the enterprise zone using a two-factor formula based on the property and payroll of the business.

This bill would modify the rules regarding expansion of enterprise zones as follows:

1. Delete the requirement that the proposed expansion area meet the general enterprise zone designation criteria that currently requires that the designation application propose effective, innovative, and comprehensive regulatory, tax, program, and other incentives in attracting private sector investment in the enterprise zone.
2. Change the requirement that "each of the adjacent cities' governing bodies" approve the expansion to require instead that "each" governing body approve the expansion. This change leaves unclear which governing bodies would be required to approve expansion. Specifically, the bill could be interpreted to include approval by the governing bodies of any or all of the following:
 - only the jurisdiction in which the enterprise zone is located;
 - the jurisdiction in which the enterprise zone is located and/or the jurisdiction into which the expansion would occur;
 - all or some of the adjacent jurisdictions.
3. Allow expansion into adjacent unincorporated areas of the county as well as into an adjacent city or cities.
4. Allow expansion into noncommercial or nonindustrial land if that land is needed as a right-of-way and is needed for contiguous expansion.
5. Specify that expansion into an adjacent city or cities, or unincorporated area of the county, must be into an area contiguous to the existing enterprise zone.

This bill would not change the amount by which an enterprise zone could be expanded.

Implementation Considerations

Implementing this bill would not significantly impact the department's programs and operations.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

This bill would not impact the state's income tax revenue.

BOARD POSITION

Pending.